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TAX FLASH NEWS

Support services and reimbursement of training expenses are not taxable as FTS under the India-USA tax treaty

Executive Summary

Recently, the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Russell Reynolds Associates Inc.[1] (the taxpayer) dealt with the issue of taxability of income from support services. The Tribunal held that the support services were not taxable as 'Fees for Included Services' (FIS) under the India-US tax treaty (tax treaty) since the support services were not in the nature of consultancy or technical services. Such services were not ancillary and subsidiary to the application and enjoyment of the right.

With respect to reimbursement of training expenses, the Tribunal observed that training provided by the taxpayer cannot strictly be called managerial or leadership training to enhance any productivity or profits but were more of an orientation program at the time of induction of the new recruit. Consideration was in the form of reimbursement of expenses for travelling, food, boarding and lodging of consultants employed by the Indian counterpart. The cost of training recovered from the Indian associate was due to such expenditure on the trainees. Accordingly, reimbursement of training expenditure cannot be treated as FIS under the tax treaty.

Facts of the case

The taxpayer, a US based entity, engaged in the business of providing human resources advisory services to its clients, on recruiting and retaining senior level executives and further assisting them in mitigating the risks associated with senior level appointment. It also provides management support services to its group companies. The taxpayer entered into 'services agreement' for providing services for an amount equal to proportionate of the provider cost i.e., without any mark up.

During the Assessment Year 2014-15, the taxpayer also received royalty income from Indian AE in terms of 'Licensing Agreement' for use of Intellectual Property Rights (IPRs) like trademarks / trade names and 'Information Technology Licensing Agreement' for use of databases, etc.

The Assessing Officer (AO) held income from support services as per 'service agreement' and reimbursement of expenses as per 'cost reimbursement agreement' as FIS under Article 12(4)(b) of the tax treaty by holding that such services met the condition of 'make available' of technical knowledge, experience, skill, knowhow, etc. However, the Commissioner of Income-tax (Appeals) [CIT(A)] held that the services did not meet the 'make available' condition but upheld the addition as FIS under Article 12(4)(a) of the tax treaty by alleging that the said services are ancillary and subsidiary to the application and enjoyment of the right specified in Article 12(3) of the tax treaty.

Tribunal's decision

Taxability of support services

Article 12(4)(a) of the tax treaty makes it clear that it is only in regard to 'rendering any technical or consultancy services', a finding can be given that they are ancillary and subsidiary to the application and enjoyment of the right.

The lower authorities made an error in distinguishing Article 12(4)(a) and Article 12(4)(b) in a manner that as for Article 12(4)(a), there was no requirement that the **services should be of the nature technical or consultancy** and only receipt of Royalty as per Article 12(3) of the tax treaty, makes Article 12(4)(a) applicable. The example relied on by the lower authorities was in regard to the contractual arrangement of US manufacturer who had agreed to provide certain 'consultancy services' to the Indian company. Thus, in such example, it was an admitted fact that the nature of services was 'consultancy services' as those services were considered related to

[1] Russell Reynolds Associates Inc. v. DCIT (ITA No.1165/Del/2019) – Taxsutra.com

the application or enjoyment of tangible. In the instant case, there was no categorical finding of the fact that the support services were in the nature of 'consultancy or technical services'. In fact, the receipts from services indicate that the same cover a large spectrum of area and would necessarily qualify as managerial services. As managerial services were not mentioned in FTS Article of the tax treaty, it cannot be taxable as FTS.

Further, on perusal of licensing agreement it was observed that the 'intangible' referred to in Article 1 means 'the intellectual property as may be amended from time to time'. It is a trademark for use of which the licensing agreement was executed. There was no recital in the agreement which would indicate that the use of tangible by an Indian Associate was in any way necessary for the effective application or enjoyment of right, property or information, for which the royalty was agreed to be paid. The services rendered were not customarily provided and it was also not so otherwise established by the tax department on the basis of any cogent evidence that such services are customarily provided in cases of licensing agreements for the use of trademarks.

The consideration for these services cannot be considered to be insubstantial portion. The most important factor being that there were separate agreements for the licensing of the intangible and the service agreement. Accordingly, the Tribunal held that the determining factors for classification of support service consideration under Article 12(4)(a) are clearly not satisfied in the present case and hence cannot be classified as FTS under the tax treaty.

Taxability of reimbursement of training services

The training was not a part of the main contract of licensing agreement for royalty and there was no corresponding recital in the licensing agreement, which required the Indian Associates and the taxpayer to enter into any agreement for providing the training. The taxpayer provided relevant training and workshops to newly recruited consultants who joined the Indian Associate and the purpose of this training was not to provide any specific technical training or share any technical knowledge, expenses, skills, know how or processes neither by way of training, there was any transfer of any technical plan or technical design.

The trainees were only sensitized to understand their job responsibility, the business model, policies, and procedures, under which the new recruits were expected to work. The training cannot strictly be even called managerial or leadership training so as to enhance any productivity or profits but were more of an orientation program at the time of induction of the new recruit. Merely because the training program was of boarding nature, that cannot change the nature of program to fall in the purview of services, for which consideration should be FIS. Rather the consideration was in the form of reimbursement of expenses on actual basis of constituents like travelling, food, boarding and lodging of consultants employed by Indian counterpart. The cost of training recovered from the Indian Associate was due to these expenditures on the trainees.

Accordingly, reimbursement of training expenditure cannot be treated as FIS under the tax treaty.

Our comments

The taxability of payments made to foreign companies towards support services has been a subject matter of litigation before Courts.

The Delhi Tribunal in the case of Inter-Continental Hotels Group (Asia Pacific) (Pte.) Ltd.[2] held that the support service was not taxable as FTS under Article 12(4) of India-Singapore tax treaty since there was no transfer of technology nor transfer of any skill or know-how, which would be regarded as services which was 'make available'. However, the Delhi Tribunal in the case of H.J. Heinz Company[3] held that support services were taxable as FTS under the Act and the tax treaty since the services were made available by a U.S. based company, to its group affiliates and benefit of same would remain available to service recipients in future in the form of technical knowledge, experience, skill etc.

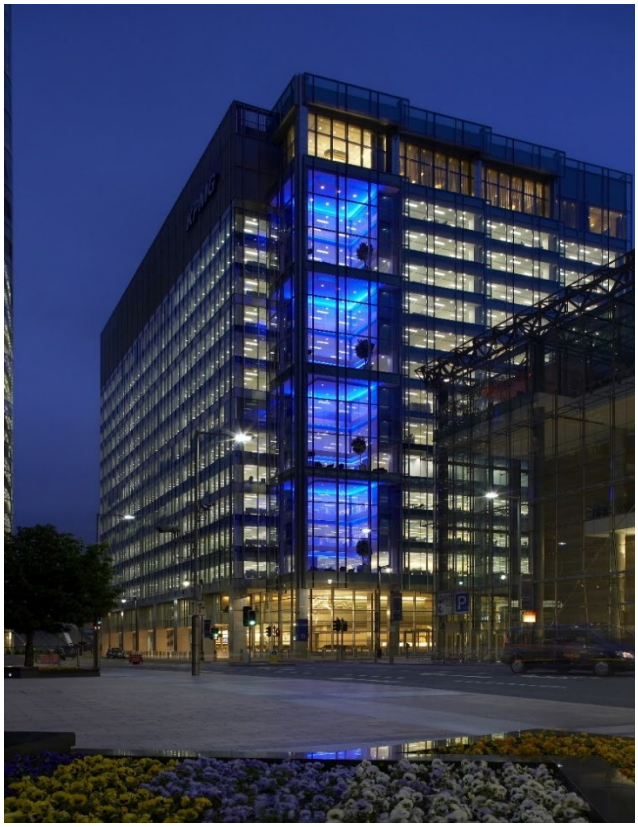
The Tribunal in the present case has held that the support services are not treated as FIS since the support services were not in the nature of consultancy or technical services.

With respect to the reimbursement of training expenditure, in some of the cases, the Courts have held that the reimbursement is not taxable where no element of profit is embedded in such reimbursement[4]. However, in some of the decisions, it was held that services provided to group companies would be liable to tax as FTS, even if no profit element is involved[5].

The Supreme Court in the case of A.P. Moller Maersk[6] observed that no profit element was embedded in the payments made by Indian agents to the foreign company. The payments were in the nature of reimbursement of cost whereby the Indian agents paid their proportionate share of expenditure incurred on common systems. Further, no technical services were rendered by the foreign company to the Indian agents. Accordingly, such payments were not taxable as FTS.

[2] Inter-Continental Hotels Group (Asia Pacific) (Pte.) Ltd. v. ACIT [2022] 192 ITD 497 (Del)
[3] H.J. Heinz Company v. ADIT [2019] 108 taxmann.com 473 (Del)
[4] CIT v. Dunlop Rubber Co. Ltd. [1983] 142 ITR 493 (Cal), Dampskibsselskabet v. ADIT [2011] 9 taxmann.com 165 (Mum)
[5] Timken India Ltd [2005] 273 ITR 67 (AAR), International Hotel Licensing Co [2007] 158 Taxman 231 (AAR)
[6] DIT v. A.P. Moller Maersk [2016] 392 ITR 186 (SC)

The Tribunal in the present case has also held that the reimbursement of actual training expenses as per ‘Cost Reimbursement Agreement’ cannot be treated FIS under the tax treaty. The cost of training recovered from the Indian associate was due to actual expenditures on the trainees.



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